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Supreme Court of the United States

OCTOBER TERM, 1940

No. 733

NICHOLAS ROERICH,
Petitioner,

against

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA.

CHARLES B. MCINNIS,
Attorney for Petitioner.

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Of Counsel.

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Nicholas Roerich prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the District of Columbia entered in the above entitled case on September 3, 1940.

Opinions Below.

The opinion of the Board of Tax Appeals, affirming, in part, the action of the Commissioner, is reported in 38 B. T. A. 567. The opinion of the United States Court of Appeals for the District of Columbia, affirming the decision of the Board of Tax Appeals, is reported in 115 F. (2d) 39. It has been added to this petition as an appendix.

Jurisdiction and Timeliness.

The judgment of the United States Court of Appeals for the District of Columbia was entered on September 3, 1940. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Acts of February 13, 1925, January 31, 1928 and June 7, 1934. On December 3, 1940 an order was made by the Chief Justice extending the time within which a petition for a writ of certiorari in this cause might be filed for a period of sixty days from December 3, 1940.

Questions Presented.

1. Whether the sum of $76,200 deposited in a bank account in the name of the petitioner during the year 1926, and certain interest thereon, was money delivered to petitioner's control as agent or trustee for the purpose of defraying the expenses of an expedition to Asia undertaken by Roerich Museum and other institutions in the City of New York, or was income of the petitioner.

2. Whether $74,271.78 in cash and securities deposited in said bank account in 1927 under similar circumstances, together with certain interest thereon, and profits from dealings in said securities, were received as such agent or trustee, or were income of the petitioner.

3. Whether the failure of the petitioner to file an income tax return for the year 1934 was due to fraud with intent to evade taxes.

Statutes Involved.

Sec. 213(a) (Revenue Act of 1926):

"Sec. 213. For the purposes of this title, except as otherwise provided in section 233—

(a) The term 'gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period."

SEC. 214(a)(1) (Statutory deductions) Revenue Act of 1926:

"Sec. 214. (a) In computing net income there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of

property to which the taxpayer has not taken or is not taking title or in which he has no equity. * * *"

SEC. 217(c)(3) (Revenue Act of 1926):

"Sec. 217. (a) in the case of a non-resident alien individual or of a citizen entitled to the benefits of section 262, the following items of gross income shall be treated as income from sources within the United States: * * *

"(c) The following items of gross income shall be treated as income from sources without the United States: * * *

"(3) Compensation for labor or personal services performed without the United States: * * *

"(e) Items of gross income, expenses, losses and deductions, other than those specified in subdivisions (a) and (c), shall be allocated or apportioned to sources within or without the United States under rules and regulations prescribed by the Commissioner with the approval of the Secretary. Where items of gross income are separately allocated to sources within the United States, there shall be deducted (for the purpose of computing the net income therefrom) the expenses, losses and other deductions properly apportioned or allocated thereto and a ratable part of other expenses, losses or other deductions which can not definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as net income from sources within the United States. In the case of gross income derived from sources partly within and partly without the United States, the net income may first be computed by deducting the expenses, losses or other deductions apportioned or allocated thereto and a ratable part of any expenses, losses or other deductions which can not definitely be allocated to some items or class of gross income; and the

portion of such net income attributable to sources within the United States may be determined by processes or formulas of general apportionment prescribed by the Commissioner with the approval of the Secretary. Gains, profits and income from (1) transportation or other services rendered partly within and partly without the United States, or (2) from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States, or produced (in whole or in part) by the taxpayer without and sold within the United States, shall be treated as derived partly from sources within and partly from sources without the United States. Gains, profits and income derived from the purchase of personal property within and its sale without the United States or from the purchase of personal property without and its sale within the United States, shall be treated as derived entirely from sources within the country in which sold, except that gains, profits and income derived from the purchase of personal property within the United States and its sale within a possession of the United States or from the purchase of personal property within a possession of the United States and its sale within the United States shall be treated as derived partly from sources within and partly from sources without the United States."

* * * * *

(g)(1) Except as provided in paragraph (2) a nonresident alien individual or a citizen entitled to the benefits of section 262 shall receive the benefit of the deductions and credits allowed in this title only by filing or causing to be filed with the collector a true and accurate return of his total income received from all sources in the United States, in the manner prescribed in this title; including therein all the information which the Commissioner may deem necessary for the calculation of such deductions and credits.

ART. 328, Reg. 69:

"*Art. 328, Reg. 69. Income derived from sources partly within and partly without the United States.*—Items of gross income not allocated by articles 317-324 or 327 to sources within or without the United States shall (unless unmistakably from a source within or a source without the United States) be treated as derived from sources partly within and partly without the United States, according to the following rules and cases:

"*Manufacturers and producers.*—Gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States, or produced in whole or in part by the taxpayer without and sold within the United States shall be treated as derived partly from sources within and partly from sources without the United States, under one of the cases named below. As used herein, the word 'produced' includes created, fabricated, manufactured, extracted, processed, cured, or aged.

"Case 1: Where the manufacturer or producer regularly sells part of his output to wholly independent distributors or other selling concerns in such a way as to establish fairly an independent factory or production price—or shows to the satisfaction of the Commissioner that such an independent factory or production price has been otherwise established—unaffected by considerations of tax liability, and the selling or distributing branch or department of the business is located in a different country than that in which the factory is located or the production carried on, the net income attributable to sources within the United States shall be computed by an accounting which treats the products as sold by the factory or productive department of the business to the distributing or selling department at the independent factory price so estab-

lished. In all such cases the basis of the accounting shall be fully explained in a statement attached to the return.

"Case 2: Where an independent factory or production price has not been established as provided under case 1, the net income shall first be computed by deducting from the gross income derived from sources partly within and partly without the United States the expenses, losses, or other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. Of the amount of net income so determined, one-half shall be apportioned in accordance with the value of the taxpayer's property within and without the United States, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the value of the taxpayer's property within the United States and the denominator of which consists of the value of the taxpayer's property both within and without the United States. The remaining one-half of such net income shall be apportioned in accordance with the gross sales of the taxpayer within and without the United States, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the taxpayer's gross sales for the taxable year or period within the United States, and the denominator of which consists of the taxpayer's gross sales for the taxable year or period both within and without the United States. 'Gross sales within the United States' means the aggregate amount of all sales made during the taxable year which were principally secured, negotiated or effected by employees, agents, offices, or branches of the taxpayer's business resident or located in the United States.

"The term 'property' as used in this article includes only the property held or used to produce income which is derived from sources partly within and partly without the United States (excluding all property held or used to produce income which is allocated or apportioned under other articles or paragraphs of these regulations). Such property should be taken at its actual value, which in the case of property valued or appraised for purposes of inventory, depreciation, depletion, or other purposes of the Revenue Act of 1924 shall be the highest amount at which so valued or appraised, and which in other cases shall be deemed to be its book value in the absence of affirmative evidence showing such value to be greater or less than the actual value. The average value during the taxable year or period shall be employed. The average value of property as above prescribed at the beginning and end of the taxable year or period ordinarily may be used, unless by reason of material changes during the taxable year or period such average does not fairly represent the average for such year or period, in which event the average shall be determined upon a monthly or daily basis. Bills and accounts receivable shall (unless satisfactory reason for a different treatment is shown) be assigned or allocated to the United States when the debtor resides in the United States, unless the taxpayer has no office, branch or agent in the United States.

"Case 3: Application for permission to base the return upon the taxpayer's books of account will be considered by the Commissioner in the case of any taxpayer who, in good faith and unaffected by considerations of tax liability, regularly employs in his books of account a detailed allocation of receipts and expenditures which reflects more clearly than the processes or formulas prescribed under cases 1 and 2, the income derived from sources within the United States."

Statement of Case.

The petitioner is an artist, scientist and writer (R. 37, 65). During the years 1926 and 1927 (and for some time both before and after those years), he was the leader of an expedition through central Asia, the aims and purposes of which were scientific and artistic (R. 65). This expedition was undertaken by petitioner at the request of two educational institutions, Master Institute of United Arts, Inc., and Roerich Museum (R. 65), and a third institution associated with them, a business corporation known as Corona Mundi International Art Center (R. 38); and with the assurance of the financial backing of these institutions (R. 66, Findings of Fact, R. 39). The arrangement between the petitioner and the directors of the three institutions was that in return for the sponsoring of the expedition they were to receive the fruits of the expedition, including the paintings which were to be painted by the petitioner while on the expedition (R. 66). It was also agreed between the petitioner and the institutions that the paintings were to receive a "special valuation" and that the total expenses would not exceed the total of such valuation of the paintings (R. 67, Findings of Fact R. 39). Manifestly the only practical effect which this arrangement could have was to provide that the paintings should receive an artificial valuation related to the amount of the expenses.

One Louis L. Horch was president of all three institutions and the actual owner of all of the stock of Roerich Museum (Findings of Fact R. 39). On May 1, 1925, Horch wrote to the petitioner that he had "subscribed" $500,000 for the expedition (Findings of Fact R. 39). Horch also held a power of attorney from the petitioner, pursuant to which he opened a bank account in petitioner's name in the Bankers Trust Company in New York City (Findings of

Fact R. 40). The expenses of the expedition were paid from this account (Findings of Fact R. 40).

The controversy with respect to the years 1926 and 1927 is upon the following questions:

> (a) Whether the sum of $76,200 deposited by Horch in this bank account during the year 1926, and certain interest thereon, was money delivered to petitioner's control as agent or trustee for the purpose of defraying the expenses of the expedition, or was income of the petitioner;
>
> (b) Whether $74,271.78 in cash and securities deposited in said bank in 1927 under similar circumstances, together with certain interest thereon, and profits from dealings in the securities, was received as such agent or trustee, or was income of the petitioner.

The finding of the Board that these payments were income turns upon the testimony of Horch that in 1926 and 1927 he paid these sums into the account as the purchase price of paintings which he bought from the petitioner (R. 82, See opinion R. 49). During these years the petitioner was in remote parts of Asia and the only communication between petitioner and Horch in any way relating to the paintings or the alleged sale, were two cables from Horch to petitioner, dated respectively October 19, 1926 and November 27, 1927, to neither of which petitioner replied, from which we quote the language which the Board has held to be corroborative of Horch's testimony.

On October 19, 1926, Horch sent the petitioner a cable containing the words

> "Loan exhibition made permanent by Odomar" (R. 90, 91, Ex. EE, R. 216).

On November 27, 1927, Horch sent to petitioner a cable containing the words

"all remaining pictures have been made permanent by etienne and odomar" (R. 88, Ex. AA, R. 211).

It was undisputed that "odomar" was a symbol or code word for Horch and "etienne" for Horch's wife (R. 88). The references to the "loan exhibition" and to making the remaining pictures "permanent," are explained as follows:

A catalogue issued by the Roerich Museum in 1926 lists five series of paintings consisting of 152 units painted in 1924 and 1925 with the annotation "(L. E.)," meaning "loan exhibition" (Findings of Fact, R. 41). In a catalogue issued in 1929, the five series of paintings are not followed by "(L. E.)" (Findings of Fact, R. 42), and Horch's explanation of the change is that the paintings had in the meantime been purchased by him and his wife and given to the Museum. The opinion below shows that the Board took this to be evidence not merely that the ownership of the paintings had changed between 1926 to 1929, but that this change of ownership had been effected in the manner explained by Horch. In order to determine whether there was any real basis for the latter inference, it is necessary to review the relationships between Roerich and the institutions from the time when the expedition was first undertaken.

The fundamental purpose of Horch was that all of the petitioner's paintings should remain in perpetuity the property of the Museum. In a letter in evidence he wrote:

> "From the moment almost when I met Prof. Roerich I had only one wish, namely, to gather all paintings of Prof. Roerich in one place, so that no one should ever get them, to keep these treasures for humanity at all times! And what did I want to do, sell a few of them to help some temporary condition" (R. 111).

It was nevertheless contemplated that it might be necessary to resort to sale of the pictures to outsiders in order to meet the expenses of the expedition. This is shown by a letter written by Roerich to Corona Mundi on July 15, 1925 (R. 42) from which we quote as follows:

> "All paintings of 1925 sent for the Loan Exhibition in Museum have the price list as in 1924, that is: 'Series of Banners of the East' at $5,000.—; for the Museum one third of this price. On thick cardboards at $3,000.—; for the Museum one third of the price. 'Benares' or 'Crossroads of Buddha & Christ' at $5,000.—but for Ch. Crane an exception one or the other. Of course I give the right to 'Corona Mundi' slightly to change the prices; depending of necessity. The frames are included into the prices of the paintings as well as expenses on transportation."

At the time this letter was written the arrangement under which the institutions were entitled to the fruits of the expedition in return for paying the expenses was in effect, but it was nevertheless realized that the Museum's possession of the paintings might be only temporary if donations were insufficient to pay the expenses of the expedition. In these circumstances, Roerich (who was an officer of Corona Mundi as well as of the other institutions) (R. 65) devised and Horch appears to have approved, the plan set forth in the letter whereby the paintings were offered by the Museum for sale to anyone who would donate the picture back to the Museum, at a price one-third of that which would be charged to one who intended to remove it. In order to make a distinction between paintings which had by such donation been put on permanent exhibition in the Museum, and those which were still subject to the contingency of sale for removal, the latter class was designated as the "loan exhibition". The "loan" involved, however,

was not a loan by Roerich to the institutions, for the institutions already owned the pictures; but a loan in the sense that the Museum, as distinguished from the other institutions, which were the original sponsors of the expedition, had only a temporary and conditional custody.

Those who paid one-third of the list price for the paintings and left them on the walls of the Museum, may have thought of the transaction as a purchase from the institutions and a donation to the Museum. It would be more realistic to regard it simply as a contribution. But in any event there is nothing in the evidence to support any finding that a transaction of this nature was intended to be a sale by *Roerich* and a subsequent donation by *Roerich* of the purchase price to the Museum. Any such interpretation would be utterly inconsistent with the admitted facts (1) that the institutions and not Roerich were financing the expedition (R. 39, 153); and (2) that Roerich accounted to the institutions for the money received from them. (This was testified to by Roerich (R. 75) and not disputed by Horch, who was the controlling officer of the institutions.) It will be contended, furthermore, that such an interpretation would be a legal impossibility, in view of the fiduciary relations existing between Horch and Roerich; but as that involves questions of law, its further discussion will be reserved for the argument.

On August 29, 1928, while in Asia, the petitioner signed a letter prepared by Horch, the effect of which was to "confirm" the sale of all of his paintings during the years 1924 and 1928 to Horch. The petitioner testified concerning this letter that he signed it because he received a message from Horch through a Miss Grant, who brought the letter to him, to the effect that the letter "was a pure formality, and that it did not affect or change in any way the original arrangements regarding the expedition and

its results" (R. 72, 73). In this testimony the petitioner is corroborated by Miss Grant (R. 128), and Horch did not contradict them. This explanation of the letter therefore stands undisputed; and the Board has made an express finding that "Miss Grant stated to petitioner that Horch wished this letter merely for technical reasons" (R. 45).

The paintings which were the subject of the alleged sale are a group listed in catalogues of the Roerich Museum (Exhibits H and I not printed, see stipulation, R. 227) as Nos. 461 to 734, inclusive, and another group not definitely identified by Horch (R. 80, 81). According to Horch's testimony "every one of them was always on the walls of the Museum" (R. 125). He also testified:

> "I did not convey to the Museum these paintings I bought, but I considered them to belong to the Museum" (R. 102, 103).

and further:

> "There is no instrument of title or transfer of title from me to Roerich Museum of paintings numbered 461 to 613 in respondent's Exhibit I. There never was one" (R. 103).

Except for the letter of August 29, 1928 (Ex. Y, R. p. 210), there is nothing in the record to suggest that Horch ever referred to the transactions in question as a sale to him, or even thought of them in that way, until the fall of the year 1935 (R. 77), when he had a break with petitioner, characterized on Horch's part by the utmost bitterness of feeling. (See Ex. 13, R. 150, 151; Ex. W, R. 205, referred to in the Statement of Evidence as Ex. U [R. 86].) Hard upon the outbreak of this hostility we note an interview between Horch and a local Revenue Agent in connection with this case (R. 96, 97), and this proceeding was begun.

It has been found by the Board that there was a close relationship between the payments made into the bank account by Horch and petitioner's applications for funds to meet the expenses of the expedition. We quote from the Finding of Fact (R. 42):

> "Petitioner's letters to his associates often contained requests for funds, which Horch usually furnished, and when the Lichtmanns returned from their visit to the expedition in 1926 they advised the trustees of the institutions that petitioner was in need of $75,000. At a meeting of the trustees, Horch offered to advance the amount." (See also testimony of witness M. M. Lichtmann, R. 131.)

The Lichtmanns returned from a visit to the expedition "in the summer or early fall of 1926" (testimony of Horch, R. 102) and the first deposit of $73,300 was made on October 1, 1926. In 1927, similarly, Mr. Lichtmann "conveyed" to Mr. Horch and the Trustees "the need of the expedition for further money" (R. 131); in this connection Horch stated that he would make contributions to the expedition (R. 128).

The total amount expended for the purpose of the expedition for a period of six years was approximately $250,000 (R. 68). All of the money deposited in the bank account was used for the purposes of the expedition (R. 69, 70).

Early in the hearing before the Board Horch was asked on cross-examination to allocate the total sum alleged to have been paid into the account to particular paintings. At R. 103, after some confused testimony on Horch's part on this subject, counsel for the Commissioner "protested that the witness could not match up the figures unless he was allowed to do so without interruption". The Member then made this comment:

"He does not seem to be able to, if I have to answer your question."

Following this comment at R. 103, 104 and 105, there was further unsatisfactory testimony on this point, concluding with the following colloquy (R. 105):

> The Witness: "* * * If you take the large pictures and work out mathematically, and take the smaller and the others, you can get to a price of some paintings there.
>
> The Member: Did you ever try to do that?
>
> The Witness: I think I might try."

The effort was resumed toward the conclusion of the hearings and Horch testified at length at R. 118-119, concluding with the apparent admission by the witness that he was unable to connect the price paid with any prices fixed by Roerich for individual pictures, and the assertion that "Roerich, not being able to sell his paintings, made this whole lot $75,000" (R. 119). There is nothing in the evidence, except this assertion, to the effect that Roerich ever made such a price for the "whole lot".

Horch testified that at the time of the deposit of $73,300 made by him in 1927, other contributions of the same nature were made by one S. N. Newberger, Miss F. R. Grant and M. M. Lichtmann and S. Lichtmann, the respective amounts being $1,000, $200 and $500 (R. 101). Horch testified: "These persons bought pictures too" (R. 101). Miss Grant, on the contrary, testified that the $200 paid by her was not a purchase but "a contribution volunteered for the expedition" (R. 127). Mr. Lichtmann gave testimony to the same effect (R. 131). Newberger, Horch's brother-in-law (R. 93), was not called as a witness. On the first sheet of Exhibit G (R. 174), in Horch's own handwriting, the annotation appears opposite the record of the Newberger,

Grant and Lichtmann contributions "toward making permanent loan exhibition".

In 1927 the whole expedition was held captive in Tibet for several months, and the institutions sought to recover damages from the Tibetan Government on this account. On July 6, 1928, the Roerich Museum, by Louis L. Horch, president, wrote a letter evidently intended to be exhibited to Tibetan officials stating that the detention of the expedition had resulted "in a loss of $250,000 to the American art institutions, under whose auspices the Roerich American Expedition has pursued its work for art and science" (Ex. 17, R. 158); and on July 14, 1928, Horch and Maurice Lichtmann, describing themselves "respectively President and Vice-President of the Roerich Museum, Master Institute of United Arts, Corona Mundi, International Art Center, New Syndicate, International Information Agency" made a sworn statement to the effect that as a result of the forcible detention of the expedition by Tibetan officials losses of $250,000 were sustained by these institutions (Ex. 16, R. 155).

Reference was made in the evidence to the purchase by Roerich Museum in November 1929 of a new series of paintings by the petitioner for $200,000—not in cash but with the understanding that 4% a year on this sum was to be paid to the petitioner. Horch himself testified that this had "nothing to do with any paintings which I had purchased," and we refer to it only to point out that concededly it has no bearing upon the transactions of 1926 and 1927 with which the Court is concerned. This applies also to the agreement made by the petitioner on May 1, 1923 (Ex. X, R. 209) giving to Corona Mundi the exclusive right to purchase all of his paintings, books and other productions during the period of his life (see Findings

of Fact, R. 38). In view of the undisputed fact that the institutions were entitled to the 1926 and 1927 paintings in return for paying the expenses of the expedition, and that the Museum actually received them, it is clear that *pro tanto* this agreement was in fact superseded by the later agreement. Not only is it the undisputed testimony of Roerich that the agreement with Corona Mundi became operative only after the expedition was over, in 1929 (R. 73); but even if it were thought of as remaining in effect during the period of the expedition, so that the institutions became in form the purchaser of the paintings, the provision that the so-called purchase price should be measured by the expenses of the expedition makes the effect of the agreement simply that the institutions should have the paintings in exchange for the expenses (see Findings of Fact as to the measurement of expedition expenses by the "valuation" of the paintings, R. 39). It is to be noted that the Roerich Museum was not incorporated until September 1923, several months after the agreement with Corona Mundi was made (R. 38); and its becoming a party to the agreement naturally occasioned some revision of the earlier arrangements.

There is also a reference in the evidence to an instrument dated September, 1928 purporting to transfer all of the paintings to a corporation called Nicholas Roerich Painting and Art Collections, Inc. (R. 54); but not only is this subsequent to the transactions involved in the case, but there is not the slightest evidence (except sheer hearsay) that the petitioner had anything to do with the alleged instrument or that it ever became or was intended to become operative.

One other item of evidence calls for brief comment, since it was relied upon by the Board as evidence that certain of the securities deposited by Horch with the

Bankers Trust Company were treated by Roerich as his individual property, thus negativing the evidence, otherwise uncontradicted, that all of the money so deposited was used for the purposes of the expedition (R. 46). It appears that in Roerich's income tax return for the year 1929 he reported a loss on three bonds of the General Motors Acceptance Company, having a cost price of $2,906.25 (Ex. V, R. 203). The Board found that this price was "proportionately equal to the price at which Horch bought '5,000 General Motors Acceptance Corp. 5's' for the account with funds from petitioner's bank account in November 1927" (Findings of Fact, R. 46). We have searched the record in vain for any evidence whatever of the cost of these bonds in 1927; but even if such evidence existed it would be an obvious *non sequitur* to find that because the three bonds had the same cost price they were three of the five bonds which Horch deposited in 1927.

One explanation of the obscurity and confusion in which Horch became involved when he testified about these transactions may be found in his statement, made on the witness stand in a suit in New York concerning his dealings with Roerich, to the effect that he changed his mind from time to time as to the legal form of the transactions. He evidently thought that it was within his power to do this, even retroactively, because he was in absolute control of the institutions, and in addition was Roerich's agent. We quote his extraordinary testimony from the record at page 108:

> "At this point, counsel for petitioner read to the witness his testimony in certain litigation entitled '*Grant* v. *Newberger*,' as follows:— 'Did you include the half million dollars that you gave to the expedition? Answer: Half a million to the expedition? Question: Yes. Answer: Well, the expedition was

handled in this way at that time: I had many ideas how to handle that particular thing. Until I came to the final conclusion I wrote a good deal about it and made changes, and everything else. As far as I know, the expedition was called many things. It was called a purchase of works of art abroad, for instance. When I was abroad I bought a lot of works of art, $150,000 worth, and so forth.'

"The witness continuing:

That half million never went into effect.

The Member: But you did answer that question in that way at that trial, did you?

"The Witness: I did, sir.

"Counsel for petitioner then read to the witness the following further testimony given by him in said litigation:—'Question: Was that just another way of labeling what should have been contributions to the exhibition? Answer: Yes, but I made many changes there when I came to figure back and forth.' "

1934 Tax

The Commissioner has assessed against petitioner a tax on a net income of $6,069 (R. 16). The petitioner does not contest this assessment, except that he alleges that in 1934, $1,300 was contributed to Roerich Museum and Master Institute of Arts, Inc., and $1,470 was contributed to Urusvati Himalayan Research Institute at Naggar, India. The Board has found that these deductions are not allowable because no proper return for the year 1934 was filed and also "on another ground" not specified. The Commissioner disallowed these deductions and assessed a tax of $314.21, to which was added a 25% penalty for failure to file a return, amounting to $78.55, and a 50% fraud penalty amounting to $157.11. As no question will be raised by the petitioner with respect to this tax, except the correctness of the fraud

penalty, only the evidence bearing upon that phase of the matter will be set forth in this statement.

The petitioner testified that Horch had attended to the filing of his income tax return from 1922 to 1935, except during the period from 1924 to 1928 inclusive (during which Roerich was engaged in the expedition to Asia and there was no occasion for filing returns) and 1933 (as to which year there is nothing to indicate that a return had to be filed) (R. 71). The petitioner further testified that he supposed in 1935 that his "arrangement with Mr. Horch as to filing income tax returns was still in existence" (R. 72); that it was "understood that said arrangement was to remain in effect while my power of attorney with Mr. Horch lasted" (R. 72); that he received an inquiry in 1935 from Mr. Horch with respect to the 1934 income tax return, to which he replied that there was no income other than what he (Horch) already knew (R. 75). Horch testified that he filed income tax returns for Roerich when he was instructed to do so (R. 86). He filed a tentative return for 1934 (Ex. V, R. 207). Before the Commissioner there was put in evidence a letter from Horch to petitioner, dated August 7, 1935 (Ex. W, R. 205), containing the following paragraph:

> "To my Letter in which I requested Information in regard to the Income which you earned in 1934 no Reply has been received by me. This Information was needed for your Income Tax Return for the American Government. You know how strict the American Government is, but this of course is entirely your affair."

There is nothing in the evidence to show that the petitioner's answer to Mr. Horch referred to in petitioner's testimony was not sent in answer to this letter Horch was unable to produce any evidence of a prior request for

information, although the respondent subpoenaed all of Horch's correspondence "pertaining to this matter" (R. 86, 87). If Horch's testimony at R. 86, 87 in this connection is carefully analyzed, it will be found to be quite consistent with the hypothesis that the petitioner answered the letter with the statement that there was no income other than what Horch already knew of. If that was the case, the evidence showed no fraud but an innocent misunderstanding. The fact that Horch filed a tentative return and wrote Roerich corroborates Roerich's testimony that he did not intentionally fail to file a return, but relied on Horch to take care of it. The issue is narrowed to whether Roerich withheld necessary data from his agent, with the intention of preventing the filing of a proper return.

The undisputed evidence proves that Horch's excuse that he lacked the necessary information to prepare the return is a dishonest pretext. Horch testified (R. 85) that he personally deposited in Roerich's bank account in 1934 the proceeds of sales of paintings amounting to $6,289, and that he knew of additional sales to a Mrs. Campbell and a Mr. Holt, amounting to $2,350; also that he kept a record of sales of Roerich's paintings in 1934, in which record he identified sales of which the purchase price totalled $6,289 (R. 91). The only source of taxable income which Roerich could have been believed by Horch to have were the proceeds of sales of his paintings in this country and interest or dividends on securities of which Horch himself had the custody; *i. e.*, everything indicates that Horch as Roerich's trusted agent did have complete information as to all Roerich's taxable income.

Specification of Errors to be Urged.

The United States Court of Appeals for the District of Columbia erred:

1. In affirming the holding of the Board of Tax Appeals that the deposit of $76,200 made in the Bankers Trust Company in petitioner's name in the year 1926, with interest thereon, constituted income of the petitioner.

2. In affirming the holding of the Board of Tax Appeals that said bank deposit of $76,200 constituted the purchase price of property sold by the petitioner during the year 1926.

3. In affirming the holding of the Board of Tax Appeals that said bank deposit of $76.200 and said interest, was received by petitioner for his personal benefit and not as an agent or trustee.

4. In affirming the holding of the Board of Tax Appeals that the deposit of $74,271.78 made in said bank account in petitioner's name in the year 1927, together with interest thereon, and the interest and profits on securities purchased out of said bank account, constituted income of the petitioner.

5. In affirming the holding of the Board of Tax Appeals that the said bank deposit of $74,271.78 constituted the purchase price of property sold by the petitioner during the year 1927.

6. In affirming the holding of the Board of Tax Appeals that the said bank deposit of $74,271.78 and said interest and profits, was received by petitioner for his personal benefit and not as agent or trustee.

7. In affirming the holding of the Board of Tax Appeals that the deficiency for 1934 was due to fraud with intent to evade taxes.

Dated, New York, N. Y., January 30, 1941.

NICHOLAS ROERICH, *Petitioner,*

By CHARLES B. MCINNIS,
Attorney for Petitioner,
Transportation Building,
Washington, D. C.

JOHN H. JACKSON,
Of Counsel.

BRIEF IN SUPPORT OF PETITION

The petition should be granted because, although this cause requires the construction of sections 217, 213(a), and 214(a) of the Revenue Act of 1926, together with Treasury Regulations 69, Article 328, promulgated under said Revenue Act, the decision below fails to construe said statutes and regulation. Their proper construction is a question of substance because these statutes are a fundamental part of the federal revenue laws and their construction with reference to non-resident aliens who have failed to file income tax returns remains unsettled by this Court and even by lower courts. It is further submitted that this petition should be granted because, with respect to other questions involved, the decision below is probably in conflict with the applicable decisions of this Court.

I.

The question of construction above stated is as follows: Where a non-resident alien sells within the United States property which he has created in a foreign country and without fraudulent intent to evade income taxes, fails to file federal income tax returns, does section 217(g)(1) permit the Commissioner, in making a return for the non-resident alien, to treat the entire proceeds of sale of the property in the United States as gross income, denying to the alien the right to have gross income computed by subtracting from gross sales the actual cost of producing the property?

The Court below, in its opinion, did not question the fact that the moneys deposited by Horch in the New York bank account, which the respondent claims were the proceeds of sales of paintings, were entirely consumed for the

purpose of the expedition to Asia. Thus it said (Appendix p. ~~35~~ 37):

> "It appears that Roerich used the disputed sums to defray expedition expenses * * *."

Assuming that the paintings were in fact sold to the Roerich Museum or to Horch, it is the petitioner's contention that the expedition expenses constituted the actual cost of production of the paintings. As the purpose of the expedition was to make these paintings, the expedition expenses were not of a collateral character such as traveling expenses and other "ordinary and necessary expenses" allowed as deductions from gross income by section 214(a). Due to the unusual facts of this case the cost of production happened to be traveling and other expenses of an expedition in Central Asia. It is apparent from Treasury Regulations 69, Article 328, Case 2A, that the "expenses, losses or other deductions", with the allocation of which that Article is concerned, are part of gross income and not of gross sales. The distinction between gross income and gross sales is there clearly recognized. It is submitted that to construe section 217(g)(1), which denies to non-resident aliens "the benefit of the deductions and credits allowed in this title" where no return has been filed, and section 214(a) which is referred to in section 217(g)(1) so as to penalize a non-resident alien to the extent of taxing him upon gross sales instead of gross income would be unjust and clearly erroneous. We have not been able to find any decision or authority supporting such a construction.

The Board of Tax Appeals held (R. ~~65~~ 56) that the petitioner was taxable on the expedition expenses because, under section 217(g)(1) he was denied the right to make any deductions. The Board treated the bank deposits in

question as gross income. The Court below refused to consider this question (Appendix p. 35) because it took the view that this question was not raised before the Board. It is respectfully submitted that the Court was in error. The petition to the Board (R. 10, 11) assigned as error the fact that the bank deposits claimed by the Commissioner to be the proceeds of sales of paintings in 1926 and 1927 were "entirely spent for the expenses of the expedition", and it was alleged in the petition that therefore these moneys were not income. If the expedition expenses were claimed as deductions, under section 214(a), disallowance of them would have been correct. However, the Board had before it the question of taxable income, of gross income. The Board erroneously affirmed the tax upon the expedition expenses, regardless of the established fact that the bank deposits were used for such expenses. This, it is submitted, was an erroneous construction of section 213(a), defining gross income as "gains, profits and income * * *." It is further submitted that the Court below had the same question before it. If the Court below had any doubt, which does not appear to be the case, that the bank deposits were entirely used for expedition expenses it should have remanded the cause for further hearing at which the petitioner would have the opportunity to prove that the bank deposits were entirely used for expedition expenses.

It is true that at the hearing the proof offered on behalf of the petitioner was almost entirely devoted to the question as to whether these paintings were sold at all. The petitioner's contention has been, and still is, that there was no sale; but that on the contrary he was employed, without compensation, by the Roerich Museum, or by Horch, to go to Asia to make a special series of paintings. Having found against him on the issue as to the sale of the paintings it

was, it is submitted, improper for the Board and for the Court below to disregard the issue as to what taxable income resulted from the sales. The plain facts of the case show that a great injustice has been done in that the petitioner has been burdened with a large income tax and penalties because of moneys which concededly constituted no profit to him.

II.

The Board's decision with respect to the effect of the transactions occurring in 1926 and 1927 is erroneous as a matter of law for the following reasons:

(a) The testimony of Horch that he purchased the paintings in 1926 and 1927 is a mere mistake of law and not evidence, (1) since it was a legal impossibility for Horch as Roerich's agent to sell Roerich's paintings to himself without communication with Roerich (*Wardell* v. *Railroad Co.* 103 U. S. 651, 658; *Neuendorff* v. *World Mutual Life Insurance Company,* 69 N. Y. 389, 392; *Restatement of Law of Agency,* Section 39; and (2) since Horch was not only disqualified as a matter of law from dealings on his own behalf with his principal, but the law made it impossible for him as an agent to modify the terms of the existing contract with the institutions in such a manner as to impose a heavy tax liability upon his principal without any advantage to the principal being possible or intended. While an agent may by error of judgment commit his principal to an unfavorable bargain, he is as a matter of law without power to act in such a manner as to result in known disadvantage to his principal. *Restatement of the Law of Agency,* Section 39, and Comment.

(b) The communications of Horch to Roerich during the years 1926 and 1927 did not purport to inform Roerich of any transaction directly between the two,

but reported merely the acquisition of the paintings by the museum for permanent exhibition. Ratification by the principal of the unauthorized acts of the agent cannot be based upon anything less than full disclosure by the agent of the nature of the unauthorized transaction.

III.

Petitioner's letter of August 29, 1928, did not constitute a ratification of the proposed sale.

(a) Because by the undisputed evidence the parties did not so intend it;

(b) Because no disclosure was made by the agent to the principal of the nature and consequences of the alleged transaction, particularly of the fact that the alleged modification of the agreement would involve the principal in heavy liability for income taxes without any compensating benefit whatever. It was the duty of the agent seeking ratification of an unauthorized transaction to make a full disclosure to his principal of such consequences. *Adair* v. *Brimmer,* 74 N. Y. 539, 554.

IV.

Even if the letter of August 29, 1928, was sufficient to raise a question of fact as to ratification of the unauthorized transaction the only income tax liability which could be affected was that for the year 1928 and not that for the years 1926 and 1927. The fiction that ratification relates back to the unauthorized transaction has no place in income tax law, since it would destroy the principle that income tax liability must be determined annually; transactions occurring after the close of the taxable year cannot alter the liability then determined. To permit taxpayers to hold transactions in suspense after the end of

the taxable year would result in great uncertainty in the administration of the law and would not in the long run be to the advantage of the Treasury. No deficiency assessment for the year 1928 can be made in this proceeding. *Blum* v. *Helvering,* 74 Fed. (2nd) 482, cert. denied, 295 U. S. 732.

V.

No income tax liability resulted from Roerich's performance of the agreement with the institutions since (a) the whole amount paid to him was disbursed for the expenses of the expedition and was never received for his own account; (b) even if all or part of amount were compensation for personal services, such services were rendered by a non-resident alien outside of the United States and were hence not subject to taxation in view of the provisions of Section 217(c)(3) of the Revenue Act of 1926. Moreover, since the appellate courts have no jurisdiction to make new findings of fact, liability, if any, must be based on a sale by Roerich to Horch.

VI.

Even if the transaction was a sale to Horch the proceeds were burdened with a trust for educational and artistic purposes and did not constitute income. *Decatur Water Supply Co.* v. *Commissioner,* 88 Fed. (2nd) 341.

VII.

The circumstances in connection with the failure to file the full return for 1934 have been set out in the statement of the case.

The Government had the burden of proof upon this issue. Section 907(a) of the Revenue Act of 1924, as

amended May 29, 1928, c. 852, § 601, 45 Stat. 872, provides:

> "In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, where no hearing has been held before the enactment of the Revenue Act of 1928, the burden of proof in respect of such issue shall be upon the Commissioner."

WHEREFORE, it is respectfully submitted that this petition for a writ of certiorari should be granted.

CHARLES B. MCINNIS,
Attorney for Petitioner.

JOHN H. JACKSON,
Of Counsel.

Appendix.

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

No. 7578

NICHOLAS ROERICH, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for Review of Decision of the United States Board of Tax Appeals.

Argued June 14, 1940.

Decided Sept. 3, 1940.

Charles B. McInnis, of Washington, D. C., and *John H. Jackson,* of New York City, for Petitioner.

J. P. Wenchel and *Robt. L. Williams,* both of the Bureau of Internal Revenue, and *Samuel O. Clark, Jr., John J. Pringle, Sewall Key,* and *Lee A. Jackson,* all of the Department of Justice, Washington, D. C., for Respondent.

Before GRONER, C. J., and EDGERTON and VINSON, JJ.

EDGERTON, J.: The petitioner, Roerich, asks review[1] of a decision of the Board of Tax Appeals that he is liable for certain income taxes. The principal questions relate to sums of $73,300 and $74,271.78 which he received in 1926 and 1927. He contends that they were contributions made to him as agent or trustee, to meet the expense of an Asiatic

[1] Under Sections 1001-1003 of the Revenue Act of 1926, 44 Stat. 109, as amended by Section 1101 of the Revenue Act of 1932, 47 Stat. 286 and Section 519 of the Revenue Act of 1934, 48 Stat. 760.

expedition. The Commissioner and the Board found that they were income which he derived from the sale of his paintings to one Horch.

Roerich, a nonresident alien, has been an artist, scientist and writer, and a leader of a mystic cult. He came to the United States in 1920. With friends and followers, including chiefly Horch, he later organized in New York three corporations concerned with artistic instruction, exhibition, or sales; Corona Mundi, Inc., Master Institute of United Arts, Inc., and Roerich Museum, Inc. The Museum was organized to acquire and exhibit his paintings and art objects. The same group organized an expedition to Asia, led by Roerich, which began in 1923 and ended in 1928. Its purposes were scientific and artistic. One purpose among a number of others was to enable Roerich to paint pictures of the East. Almost all the money for the expedition came from Horch.

On April 30, 1923, before starting on the expedition, Roerich executed to Horch general powers of attorney which authorized him to represent Roerich in all matters and, specifically, to sell such of Roerich's paintings at such prices and on such terms as Horch might deem advisable. The next day Roerich executed an agreement with the Institute and with Corona giving them "the exclusive right to purchase all the artistic results of the Expedition, such as my paintings, drawings and sketches, as well as such paintings as I may complete thereafter. The price of these paintings may be established by mutual agreement and may be determined according to the present prices of my paintings. The paintings may be purchased either in series or individually, as may be determined in each case. This offer is accepted by me in view of the wish expressed by the Directors of the above-mentioned Institutions to found in the future a Museum in which my paintings will be permanently preserved."

Horch maintained an account for Roerich at a New York bank, and sent him statements of receipts and disbursements. Between 1923 and 1929 Roerich sent to New

York from Asia some 400 paintings, including 189 in 1925-1927. Itemized lists, with valuations, accompanied them. In October, 1926, Horch deposited $73,300 in Roerich's account and cabled Roerich "Loan exhibition made permanent" by Horch. He later sent Roerich a financial statement in which the words "Making permanent Loan Exhibition, L. L. Horch, N. S. Horch" were written opposite the $73,300 item. Horch testified that this meant that he bought a certain series of paintings, and that the price was fixed in a letter from Roerich which he no longer had; that he bought the pictures to be exhibited permanently at the Roerich Museum, Inc., all the shares of which he owned. His statement to Roerich for 1927 includes the following deposits by Horch in Roerich's account: "Permanent making remaining pictures" (sic), $25,000; "Payment Mongolian Paintings," $20,000 and $19,421; "Payment balance due on Finnish Paintings," $716.66; and "Deposited $9134.12 worth of Bonds still due on paintings, Mongolian series." These 1927 items total $74,271.78. On November 27, 1927, Horch cabled Roerich: "all remaining pictures have been made permanent by" Horch and his wife. Horch testified that all these payments represented purchases of Roerich's paintings. The paintings were all hung in the Museum.

In 1928 Roerich signed the following letter to Horch: "I herewith confirm that all my paintings and drawings from Finland, as well as all paintings of mine, during the years from 1924 to 1928, including the paintings sent from Darjeeling, from Kashmir and from Urga, and cited in the catalogue of the Roerich Museum, were sold to you." Roerich testified that he signed this letter on the oral representation of an agent of Horch that the letter was "for technical reasons" and "a pure formality." Horch's agent confirmed this and testified that she explained to Roerich that the "technical reasons" pertained to "the building occupied by the Roerich Museum." Roerich testified that he did not sell the paintings, but that they became the property of the Museum by an agreement between

him and it that it should receive the fruits of the expedition, including paintings. This alleged agreement was not put in evidence, and no definite form or date was attributed to it. Roerich testified that Horch donated the sums in question for the purposes of the expedition. But Roerich conceded that in 1926 he sold certain paintings to persons other than Horch. These paintings were among the "fruits of the expedition."

These other sales, Roerich's prior agreement to sell expedition paintings to the Institute and Corona, his prior authority to Horch to sell his paintings, and his 1928 confirmation of sales of expedition paintings, to Horch, contradict Roerich's present contention that no expedition paintings were ever his property and that all of them, including those here in issue, belonged to the Museum as soon as they were produced. We think the Board's finding that the disputed transactions in 1926 and 1927 were sales to Horch is supported by substantial evidence. It is therefore not subject to review.[2]

Roerich urges that Horch, as Roerich's agent, was disqualified from selling Roerich's pictures to Horch. But Roerich was not disqualified from selling his own pictures to Horch, and Horch violated no duty in buying his principal's property if the principal negotiated or ratified the sales with knowledge of the material facts. There is substantial evidence, including Roerich's signed statement of 1928, that he negotiated or ratified the sales to Horch. It is possible that, as Roerich in effect contends, his intention in signing that statement was to misrepresent the facts in order to perpetrate a fraud on creditors of the Museum; but in the light of the other evidence, the Board might reasonably believe that his signed statement was true in respect to the paintings here in issue. His counsel refer to "the alleged ratification of 1928" and urge that (1) it could not retroactively create tax liabilities for 1926 and 1927, and (2) it

[2] *Helvering* v. *National Grocery Company*, 304 U. S. 282, 58 S. Ct. 932, 82 L. Ed. 1346, *rehearing denied*, 305 U. S. 669; *Colorado National Bank* v. *Commissioner*, 305 U. S. 23, 59 S. Ct. 48, 83 L. Ed. 20.

could not be valid, because Horch failed to disclose to Roerich that he had not reported the sales as income for those years. This assumes that Roerich's 1928 letter was an attempted ratification of previously invalid sales. It was, on the contrary, an admission that valid sales, duly authorized or ratified, had previously occurred. Sales to Horch created no greater tax liability than sales to a third person would have created; and Roerch does not contend that the sales were in other respects unfair, or that he was ignorant of other facts which would have affected his willingness to sell.

Even if the principle of *Decatur Water Supply Co.* v. *Commissioner*, 88 F. 2d 341, were extended to hold that money received by a person under a moral obligation to use it for artistic purposes is not income, it would not aid Roerich. It appears that Roerich used the disputed sums to defray expedition expenses but it is not found, or conclusively shown, that he was in any way obligated to do so. His contention that these sums, if income, were "compensation for labor or personal services performed without the United States" by a non-resident alien, and were therefore exempt from tax, assumes that he did not, as the Board found that he did, own and sell the pictures, but was hired to paint them for the Museum.

Petitioner argues that he should not be taxed on the entire income derived from his pictures, because it was only partly from sources within the United States; also that he should be allowed deductions on account of the cost of producing the pictures. As these contentions were not made before the Board but are raised for the first time on this appeal, we do not consider them. The record contains no evidence concerning the cost of producing the pictures, though there is evidence of the cost of the entire expedition which had the production of pictures as one of its several purposes.

The Board found that the petitioner's failure to file a return for 1934 was due to fraud with intent to evade tax, and assessed a 50 per cent penalty on the amount due, pursuant to Section 293(b) of the Revenue Act of 1934.

From April, 1934, to January, 1936, he was absent from this country on a second Asiatic expedition. Horch, under his power of attorney, had filed income tax returns for him in 1930, 1931, 1932, and 1933. In March, 1935, Horch filed a "tentative return" for 1934, which contained the words "Estimated no tax" and showed no income except one item of interest. On August 7, 1935, Horch wrote to petitioner: "To my Letter in which I requested Information in regard to the Income which you earned in 1934 no Reply has been received by me. This Information was needed for your Income Tax Return for the American Government. You know how strict the American Government is, but this of course is entirely your affair." Petitioner testified that the arrangement with Horch as to filing returns was still in existence in 1935, and that in reply to an inquiry from Horch in 1935 he wrote that "there was no income other than what he already knew." Horch testified that in 1934, before Petitioner left New York, Horch asked him if he wished Horch to take care of income tax returns, and petitioner said he would write Horch "all the details of what to do" and give him instructions about it. Horch continued, "I did not know what the man did. The proceeds of sales of paintings which were received and deposited by me were only a part of petitioner's income. . . . I had to follow his instructions. . . ." The record shows that in the spring or summer of 1935 petitioner and Horch fell out. On the conflicting evidence, the Board might have found either that Horch had all the facts and the authority necessary to enable him to file a return and that petitioner relied on him to do so, or that petitioner knew that Horch could not or would not file a return. The finding of fraud based on the latter view was supported by evidence and must be sustained.

Affirmed.

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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 733

NICHOLAS ROERICH, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 36–57) is reported in 38 B. T. A. 567. The opinion of the Court of Appeals (R. 233–238) is reported in 115 F. (2d) 39.

JURISDICTION

The judgment of the Court of Appeals was entered on September 3, 1940 (R. 239). The time within which a petition for a writ of certiorari

could be filed was extended for a period of sixty days from December 3, 1940, by order of the Chief Justice (R. 240). The petition for a writ of certiorari was filed on January 31, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Did certain amounts which were transferred to the petitioner during 1926 and 1927 represent the purchase money for certain pictures painted by the petitioner, and therefore income to him, or were they merely advances to defray the expenses of a scientific expedition conducted by him?

2. Was the failure of the petitioner to file an income-tax return for the year 1934 due to fraud with intent to evade taxes under Section 293 (b) of the Revenue Act of 1934?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved herein are set forth in the Appendix, *infra*, pp. 7–12.

STATEMENT

This case involves income taxes for the years 1926, 1927, and 1934. The facts, as found by the Board of Tax Appeals (R. 37–49), may be summarized as follows:

The petitioner, a nonresident alien, is an artist and scientist (R. 37). With various followers, in-

cluding Louis L. Horch, his chief financial backer, he organized three corporations concerned with artistic instruction, exhibition and sales: Corona Mundi, Inc., Master Institute of United Arts, Inc., and Roerich Museum, Inc. The museum was organized to acquire his own artistic productions (R. 38–39). During 1923 to 1928 he led an expedition to Asia for scientific purposes and to enable him to paint pictures of the East (R. 66, 98). Practically all the financial backing of the expedition came from Horch, who had become interested in the petitioner's artistic activities and cultural enterprises (R. 38–39). While the expedition was in progress, the petitioner painted several hundred pictures and sent them back to the United States, where they were hung in the museum (R. 41). During 1926, Horch, who held a power of attorney to receive petitioner's money and maintain a bank account for him (R. 40), deposited $73,300 of his own money in Roerich's bank account (R. 42), and in 1927, deposited $74,271.78 (R. 54). At the same time some other amounts were paid and deposited by other persons (R. 42, 54).

The principal issue in the case is whether the paintings were purchased by Horch and given by him to the museum, or were given to the museum by Roerich, who received the money merely as agent for Horch and the others to defray the costs of the expedition. Horch's authority under the power of attorney included the power to sell paintings for

the petitioner, who had agreed before departing to allow the Master Institute and Corona Mundi to purchase his paintings at prices to be established by mutual agreement and according to the "present prices" of his paintings (R. 40). His purpose was to have the paintings hung in the museum. Horch sent the petitioner several communications to Asia reporting on the bank balances and advising of deposits and purchases of paintings by Horch (R. 42–43, 52). Also, petitioner signed a letter in 1928 confirming the fact that the paintings had theretofore been sold to Horch (R. 45).

The Board held that Horch bought the paintings from Roerich and that the amounts deposited in the bank account were taxable income to Roerich for the years involved, 1926 and 1927. The Court of Appeals affirmed the decision of the Board.

A further issue arises out of the failure of Roerich to file any return of his income for 1934. It is admitted that there was net taxable income in an amount to warrant the filing of a return and payment of a tax. Petitioner concedes that sales of paintings took place in that year which gave rise to the income (Pet. 20). The Commissioner assessed a 50 per centum penalty on the ground that this failure was due to fraud with intent to evade tax, and the Board of Tax Appeals and Court of Appeals upheld the Commissioner's action.

ARGUMENT

This case presents neither a conflict of decisions nor a question of general importance. The central issue is simply whether the findings of the Board are properly supported by the record.

The Board determined that the amounts deposited to petitioner's account in 1926 and 1927 represented payment for various paintings, and were not merely advances to be used by petitioner on his expedition. The record shows that those amounts were treated as payment for the pictures involved not only by Horch, but by the petitioner himself. In the circumstances, the court below correctly refused to disturb the Board's findings, which were thus amply supported by the record.[1]

The court below likewise correctly affirmed the Board's finding as to fraud for the year 1934 (cf. *Helvering* v. *Kehoe,* 309 U. S. 277), and, in any event, neither that question nor the questions with respect to the years 1926 and 1927 call for further review by this Court.

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[1] The brief in support of the petition makes various contentions unrelated to the questions presented in the petition, and those contentions are therefore probably not properly before the Court. See Rule 38 (2). In any event they appear to be wholly without merit. For example, the suggestion that petitioner should be allowed to deduct the expenses of the expedition is foreclosed by the specific requirement in Section 217 (g) (1) which allows deductions to nonresident aliens only where a return has been duly filed; and the record shows that he did not file returns for the years 1926 and 1927 (R. 48).

The petition should be denied.

Respectfully submitted.

FRANCIS BIDDLE,
Solicitor General.

SAMUEL O. CLARK, JR.,
Assistant Attorney General.

SEWALL KEY,
MICHAEL H. CARDOZO, IV,
Special Assistants to the Attorney General.

FEBRUARY 1941.

APPENDIX

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 213. For the purposes of this title, except as otherwise provided in section 233—

(a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period.

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SEC. 217. * * *

(g) (1) Except as provided in paragraph (2) a nonresident alien individual or a citizen entitled to the benefits of section 262 shall receive the benefit of the deductions and credits allowed in this title only by filing or causing to be filed with the collector a true and accurate return of his total income received from all sources in the United States, in the manner prescribed in this title; including therein all the information which the Commissioner may deem necessary for the calculation of such deductions and credits.

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Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

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(b) *Fraud.*—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3176 of the Revised Statutes, as amended.

U. S. C., Title 26, Sec. 293.

Treasury Regulations 69, promulgated under the Revenue Act of 1926:

ART. 328. *Income from the sale of personal property derived from sources partly within and partly without the United States.*— Items of gross income not allocated by articles 317–324 or 327 to sources within or without the United States shall (unless unmistakably from a source within or a source

without the United States) be treated as derived from sources partly within and partly without the United States. Such income derived from the sale of personal property may be divided into two classes: (A) income derived from sources partly within the United States and partly within a foreign country, and (B) income derived from sources partly within the United States and partly within a possession of the United States.

A. The portion of such income derived from sources partly within the United States and partly within a foreign country which is attributable to sources within the United States shall be determined according to the following rules and cases:

Personal property produced and sold.—Gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a foreign country, or produced (in whole or in part) by the taxpayer within a foreign country and sold within the United States shall be treated as derived partly from sources within the United States and partly from sources within a foreign country under one of the cases named below. As used herein the word "produced" includes created, fabricated, manufactured, extracted, processed, cured, or aged.

Case 1 A. Where the manufacturer or producer regularly sells part of his output to wholly independent distributors or other selling concerns in such a way as to establish fairly an independent factory or production price—or shows to the satisfaction of the Commissioner that such an independent factory or production price has been otherwise

established—unaffected by considerations of tax liability, and the selling or distributing branch or department of the business is located in a different country from that in which the factory is located or the production carried on, the net income attributable to sources within the United States shall be computed by an accounting which treats the products as sold by the factory or productive department of the business to the distributing or selling department at the independent factory price so established. In all such cases the basis of the accounting shall be fully explained in a statement attached to the return.

Case 2 A. Where an independent factory or production price has not been established as provided under case 1 A, the net income shall first be computed by deducting from the gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a foreign country or produced (in whole or in part) by the taxpayer within a foreign country and sold within the United States, the expenses, losses, or other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. Of the amount of net income so determined, one-half shall be apportioned in accordance with the value of the taxpayer's property within the United States and within the foreign country, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the value of the taxpayer's property within the United

States, and the denominator of which consists of the value of the taxpayer's property both within the United States and within the foreign country. The remaining one-half of such net income shall be apportioned in accordance with the gross sales of the taxpayer within the United States and within the foreign country, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the taxpayer's gross sales for the taxable year or period within the United States, and the denominator of which consists of the taxpayer's gross sales for the taxable year or period both within the United States and within the foreign country. The "gross sales of the taxpayer within the United States" means the gross sales made during the taxable year which were principally secured, negotiated, or effected by employees, agents, offices, or branches of the taxpayer's business resident or located in the United States. The term "gross sales" as used in this paragraph refers only to the sales of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a foreign country or produced (in whole or in part) by the taxpayer within a foreign country and sold within the United States, and the term "property" includes only the property held or used to produce income which is derived from such sales. Such property should be taken at its actual value, which in the case of property valued or appraised for purposes of inventory, depreciation, depletion, or other purposes of taxation shall be the highest amount at which so valued or appraised, and which in other cases shall be

deemed to be its book value in the absence of affirmative evidence showing such value to be greater or less than the actual value. The average value during the taxable year or period shall be employed. The average value of property as above prescribed at the beginning and end of the taxable year or period ordinarily may be used, unless by reason of material changes during the taxable year or period such average does not fairly represent the average for such year or period, in which event the average shall be determined upon a monthly or daily basis. Bills and accounts receivable shall (unless satisfactory reason for a different treatment is shown) be assigned or allocated to the United States when the debtor resides in the United States, unless the taxpayer has no office, branch, or agent in the United States.

Case 3 A. Application for permission to base the return upon the taxpayer's books of account will be considered by the Commissioner in the case of any taxpayer who, in good faith and unaffected by considerations of tax liability, regularly employs in his books of account a detailed allocation of receipts and expenditures which reflects more clearly than the processes or formulas herein prescribed, the income derived from sources within the United States.

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